Jim Young
President and Chief Executive Officer

July 17, 2006

The Honorable W. Douglas Buttrey
Chairman
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001

Re: Railroad Service Demands

Dear Chairman Buttrey:

Union Pacific Railroad Company provides this response to your letter of June 28, 2006, seeking information about our service plans for the remainder of the year. We will post this letter on Union Pacific's website, as we have all major communications informing our customers about our plans.

Our responses to your specific requests are as follows:

- **"The steps Union Pacific is taking to ascertain demand for and prepare for this year's peak shipping season."**

Accurate forecasting of traffic demand is critical to sizing and deploying resources throughout the year, particularly during the peak season. Union Pacific develops detailed forecasts of transportation demand annually and updates those forecasts at least quarterly. Our forecasts are based on frequent and detailed communications with our customers regarding their anticipated shipping needs. We also consider public and private forecasts of economic indicators, as well as changes in shipping patterns caused by fluctuations in the national and international economies.

In 2006, our forecasting process has undergone another cycle of improvement. We have piloted new advanced statistical tools to assist our forecasters. These tools, and our ongoing focus on forecasting, have helped produce incremental improvement in the accuracy of our outlook. The challenge continues to be predicting not only the level of the demand for our service, but also where that business will flow on our network. Macro predictions of total volume are helpful, but greater precision is important. Therefore, we have devoted a great deal of energy and effort to determining where and when the traffic will move. Market shifts and weather conditions, like last year's major hurricanes, can result in significant changes in traffic patterns.

Demand for our transportation service has been stronger than ever so far in 2006. We continue to see signs that there is no longer a traditional "peak season." International intermodal volume has been particularly strong throughout the year.

May and June this year were the two largest volume months (measured by units and seven-day average) ever for Union Pacific. This marks the first time our record month for carloadings has been set outside the traditional peak season. June's seven-day carloading average of 198,182 topped the record set last November by 5,000 cars per week. June volumes peaked at 201,467 for the seven-days ended June 17. This is Union Pacific's all time seven-day carloading record, topping the previous record set during peak last November by just over 3,000 cars.

Through the first six months of 2006, Union Pacific has experienced increased growth in traffic volume of five percent over the same period in 2005. With this volume already behind us, every indication is that traffic demand for the balance of 2006 will continue at a record pace.

As in past years, we expect to see some peaking in international intermodal volumes as we move though the fall. Our operational initiatives, the opening of major new intermodal ramps in Dallas and Salt Lake City, along with expansion at our Marion, AR, facility in the Memphis area will help us handle this volume. We are also working with the ports and ocean carriers to improve the efficiency of our operation, particularly in the LA Basin. We are aggressively repositioning equipment (both locomotives and empty cars) to address the imbalance of imports over exports that come into the Los Angeles area.

Agricultural commodities historically have had a peak shipping season in the fall to coincide with harvest season. Union Pacific does not expect any significant peak in grain shipments this fall. In fact, volumes moving on Union Pacific may be softer this year due to weak wheat exports.

- "Union Pacific's performance goals for the remainder of this year."

Union Pacific continues to focus on improving performance as measured by key metrics. The most important of these remain average system velocity, terminal dwell time, and total car inventory. Continued implementation of actions outlined in last year's letter has resulted in a more efficient and resilient network and allowed us to handle the higher volumes through the first half of the year without slippage in velocity. June terminal dwell improved two hours versus June 2005, even as volume climbed 12,000 cars per week. We have also managed our car inventory aggressively to avoid congestion in yards and terminals that can produce severe negative impact on train speed. Our system inventory has remained relatively flat, and recently declined, despite the strong and continuous demand measured by our carloadings. In fact, our second quarter inventory as a percentage of carloads has declined markedly. This indicates improved car cycle times on our network.

Continued efforts as outlined below will drive additional improvement in our performance and enable us to meet peak demand.

- "Union Pacific's plans for achieving those performance goals."

Plans for driving continuous improvement in performance focus on the five critical resources—workforce, locomotives, freight cars, main lines and terminals. Union Pacific continues to make great progress in all five areas.

- Union Pacific's train and engine employee workforce will grow by over 600 employees in 2006. The net increase since 2003 will be over 1,500 engineers and nearly 2,200 conductors.

- Union Pacific is adding 200 new road locomotives to our fleet in 2006. We have taken delivery of 120 locomotives already. We expect to receive the other 80 by peak season. In addition, we are acquiring 40 low-emission units for service in our yards this year, with an additional 30 scheduled to be delivered in 2007.

- We are acquiring 2,100 freight cars in 2006, mostly covered hoppers, along with auto racks and gondolas. All the covered hoppers and gondolas are anticipated to be in place for peak season.

Additional capacity on our main lines and in our terminals is created by operational improvements, such as implementation of our Unified Plan and Customer Inventory Management System (CIMS). Capital projects also increase the physical capacity of our railroad locations.

Unified Plan: In our response to the Board last year, we highlighted initial implementation of our Unified Plan. This is a fresh-look approach to our operations that produces a more efficient transportation plan and generates capacity by making better utilization of resources and track space.

The Unified Plan continues to improve network efficiency as we handle record traffic volumes. Comparing 2^{nd} Quarter 2006 results with 2^{nd} Quarter 2005, when we initially implemented Unified Plan, the number of switch events was flat despite the higher carload volumes. As a result, the switch event rate improved eight percent. Work events were reduced by nine percent and the work event rate improved 17 percent. The number of direct, point-to-point, trains in the scheduled network has increased to 44 percent from 33 percent since the inception of the Unified Plan.

As part of the Unified Plan, we moved most automotive traffic out of North Platte. This has provided better service to the auto industry while freeing 15 percent capacity in the world's largest freight yard. This enhances our ability to move Powder River Basin coal trains through North Platte. Also, the implementation of the Unified Plan for our Chicago intermodal traffic, coupled with application of industrial engineering concepts, increased lift capacity at our Chicago area terminals by 25 percent.

During the second quarter, we implemented additional run-through trains to and from Mexico, reduced work events on the Sunset Route by implementing more point-to-point manifest trains, improved network blocking for North Little Rock and Houston to reduce terminal car volumes and congestion, and retasked our yards in San Antonio to create capacity for additional business anticipated with the opening of the new Toyota plant later this year. We are also redesigning our Intermodal network between the Midwest, Northern California, and the Pacific Northwest to reduce network workload.

Customer Inventory Management System (CIMS): We began CIMS last year in the Phoenix area. It was so successful that it has been and continues to be expanded to many new locations across the network. CIMS is a car demand management process that matches the flow of rail cars to and from customer locations with the track capacity at those locations. This balance means fewer cars in rail yards, which in turn decreases terminal dwell time, reduces switching and congestion, and improves throughput. In terminals where CIMS has been implemented, we have seen dwell time improve by 20 to 25 percent and switching reliability for our customers improve by 35 to 50 percent. Through mid-year, we have implemented CIMS for about 60 percent of the movements to and from industry; and we are on track to cover 75 percent by year-end.

Other Inventory & Demand Management Initiatives: In addition to the major initiatives noted above, Union Pacific has undertaken a series of efforts with our customers to obtain better utilization of capacity. Some have been underway for approximately a year or more, while other initiatives are just being rolled out with our customers. For example, we have encouraged customers to operate seven days per week in certain areas (e.g., unloading rock at destinations in Texas) and to ship bulk commodities in larger unit trains so that the network can accommodate more volume without adding trains. As a result, UP uses crews and locomotives more efficiently and handles more product. We have also added financial incentives to turn rail equipment faster so that extra cars do not fill our yards and terminals.

We are also publishing new guidelines for service to new industry locations so that shippers have a better understanding of the constraints on our system. In some instances, additional infrastructure will be required to allow us to serve new customers without harming service to current customers. Our efforts to remove work events from main line track and avoid new work events produce incremental capacity that enables us to handle record volumes of traffic, while we plan, design, and construct additional capital enhancements to our system.

Capital Projects:

Our 2006 capital plan was designed to maximize capacity going into what will clearly be a record-setting peak season. Union Pacific's approximately $2.8 billion capital plan for 2006 includes $1.5 billion for ongoing maintenance of the railroad, $305 million for capacity expansion and $180 million for new commercial facilities, as well as the equipment acquisitions highlighted above.

Here are some of the significant capital expenditures Union Pacific is making this year to accommodate increased demand.

- The Sunset Corridor between West Colton, CA, and El Paso, TX, remains a high priority. We are adding another 56 miles of second main track this year, with 30 miles already completed and another 10 miles to be completed by mid-August. By the end of 2006, this 760-mile route will be approximately 50 percent double-tracked. Continued doubletracking eventually will enable Union Pacific to nearly double the fluid train capacity of this critical corridor, which connects the LA Basin with all southern U.S. markets and the major eastern rail gateways.

- Central Corridor – We are adding 60 miles of new Centralized Traffic Control on our east-west main line in eastern Iowa this year, with 30 of those miles already in service. We also completed a run-through, by-pass facility at Marysville, KS, that will allow us to expedite coal and other trains through this corridor. We have also added run-through tracks and reconfigured operations at our Armourdale Yard near Kansas City to support coal growth and expedite automotive handling.

- Powder River Basin and Other Coal Projects – With BNSF, we added 19 miles of third main track in the South Powder River Basin region between Reno and Nacco, WY. We will be adding high-speed crossovers at various locations along the 19-mile corridor. That work is expected to be completed by early September. We are installing three additional run-through tracks in North Platte dedicated to fueling and servicing coal trains. Meanwhile, we are working on over $100 million of additional 3rd and 4th main line trackage on the SPRB Joint Line that will be completed by the end of 2007. We have increased train throughput with siding extensions on the Moffat Tunnel Subdivision to accommodate coal growth from Colorado and Utah. We added a staging track in our Marion Subdivision to support Southern Illinois coal growth, and worked with BNSF on a connection a Lilbourn, MO, for improved access to the local power plant.

- Midwest Ethanol – We completed a number of capacity projects to support the growth in our ethanol business. We added yard tracks and sidings and completed main line by-pass track at Eagle Grove, IA; Iowa Falls, IA; and Mankato, MN.

- Salt Lake City – We completed a new, 260-acre intermodal terminal in Salt Lake City to handle the projected intermodal growth in this region. The new state-of-the-art facility features four loading tracks and has an annual lift capacity of 210,000 containers. We also added capacity at our Roper automotive facility in Salt Lake City.

- Los Angeles Basin – We extended our lead track out of our East Los Angeles Intermodal yard to allow direct access to the support yard without interrupting main line operations. Also, we added a new segment of double track on our LA Subdivision to remove a bottleneck.

- Arizona – We will be adding two 6,000-foot industrial support tracks at Casa Grande, AZ, during the third quarter. This will allow us to remove switching from the main line and improve velocity through this area of the Sunset Corridor that serves the LA Basin, while improving our service to customers in the important and growing Phoenix market.

- Texas – We extended sidings on our Brownsville Subdivision, and extended switching tracks in our South San Antonio yard. We also upgraded a connection to our Kerrville branch line in San Antonio to support our South Texas rock business. We are also installing Automatic Block Signals (ABS) between Houston and Shreveport to facilitate bi-directional train movement in this area and eliminate "dark" territory on a route that carries high volumes of chemicals.

- Oregon – We added a siding east of Portland that has increased staging capacity for the area.

Coal Transportation:

Coal transportation is a significant part of our business. In our letter to the Board last year, we explained the challenges and frustration Union Pacific experienced due to developments in the Southern Powder River Basin (SPRB). We have made tremendous strides since then. Nevertheless, rail transportation of coal to utilities has been the center of significant debate this year in Washington and around the country. The demand for coal from the SPRB is at record levels and is not expected to abate anytime in the near future. The entire supply chain must work efficiently and without interruption to meet this demand.

Ascertaining the "real" demand for coal transportation and mine capabilities presents the challenge of determining the amount of coal that will be available for loading at the mines so we can transport it. Receivers want substantially more coal in 2006 (approximately 15 to 20 percent more than 2005) both for current consumption and rebuilding inventories.

While there is a great deal of publicity about the railroads' ability to fulfill the growing demand, it is clear that the rail transportation portion of the supply chain is operating much more efficiently than one year ago. The SPRB Joint Line in Wyoming has set a number of records for trains originated in one day (May 1, 2006), in one month (January 2006), and as a daily average of trains in one month (June 2006). Through the first half of this year, UP coal loadings—led by SPRB—have set loading records for (i) three of the six months, (ii) the second quarter, and (iii) the first half of the year. UP's SPRB tons increased six percent in the first half of 2006 over 2005, which held the previous record for first-half loadings.

On the other hand, Colorado and Utah loadings have lagged behind 2005 production levels. Colorado mines have experienced roof collapses, gas accumulation, and persistent problems with longwalls. The production shortfall subsided during the second quarter; and UP was able to move 1021 trains, 13 percent more trains (and 18 percent more tonnage) than during the first quarter, without difficulty.

Other parts of the supply chain have experienced challenges that affect the total volume that the railroads can deliver. The SPRB mines have encountered production and loading bottlenecks resulting in 277 missed loadings on UP through the first six months of 2006. Similarly, demand substantially exceeding capacity at river terminals has reduced deliveries periodically, lengthened cycle times and created congestion on rail lines.

For our part, Union Pacific has done virtually everything it can to prepare to transport the record volume of coal in 2006. These steps include many of those noted above: acquiring high horsepower locomotives; adding capacity on the SPRB Joint Line, at North Platte, at Marysville, on the Kansas City-St. Louis corridor, and in eastern Nebraska/western Iowa; and aggressively hiring and training of train crews.

We continue to work with our customers to reduce unloading delays, to expedite the return of empty trains for loading, and to increase the amount of coal delivered with each train where possible. Several initiatives are underway to maximize the size of trains delivered to customers in order to take full advantage of each train slot.

The record volume of coal Union Pacific has handled so far reflects the results of our efforts in numerous areas to be responsive to our customers' needs. We are confident that we can continue to improve on these results.

- "Union Pacific's plans to communicate these steps, goals, and plans to customers."

As noted in the opening paragraph, this letter will be placed on our website. Union Pacific will, as it always has, continue to provide information on our website regarding our performance and plans. Since we sent our last year's peak season plan letter to the Board on July 15, 2005, we have posted on our website five letters to customers from Jack Koraleski, Executive Vice President Marketing & Sales, discussing our plans and challenges. This is in addition to numerous other communications via press releases, as well as customer specific communications that we have distributed in order to keep our customers informed.

Union Pacific will participate in the AAR's peak season forum this September in St. Louis. Jack Koraleski and Dennis Duffy, Executive Vice President Operations, will represent Union Pacific. This is yet another opportunity for customers to hear our plans and ask questions about items of interest to them. Again, these efforts are in addition to our daily ongoing direct contacts with customers by our Marketing & Sales staff.

Sincerely,

Jim Young

Copies:
Vice Chairman Francis P. Mulvey
Mr. Edward R. Hamberger, Association of American Railroads